IN THE

Supreme Court of the United States

October Term, 1978

No. 78-78-404

FIRST PENNSYLVANIA BANK N. A.,
Petitioner,

v.

GEORGE R. MONSEN, et al.,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioner, First Pennsylvania Bank N. A. ("Bank"), respectfully prays that this Court grant a Writ of Certiorari to review the opinion and judgment of the Court of Appeals for the Third Circuit entered on June 14, 1978. That decision reversed the district court's judgment n.o.v. in favor of the Bank on the securities claim, thereby reinstating the jury's verdict against the Bank, and affirmed the district court's dismissal of the plaintiffs' pendent state claim and its refusal to enter judgment on that claim.

OPINIONS BELOW.

The opinion of the Third Circuit to which this Petition is addressed is unofficially reported in [Current] FED. SEC. L. REP. (CCH) at ¶ 96,479 and has not yet been officially reported. A copy of the Opinion is reproduced as Appendix A to this Petition at pages A1 through A24. The Memorandum and Order of the United States District Court for the Eastern District of Pennsylvania dated April 27, 1977 has not been officially reported; it appears as Appendix B at pages A25 through A31.

JURISDICTION.

The opinion and judgment of the Third Circuit were filed on June 14, 1978. No Petition for rehearing was filed. This Petition for a Writ of Certiorari is being filed within ninety (90) days of that date.

Jurisdiction of this Court is invoked pursuant to 28 U. S. C. § 1254(1).

QUESTIONS PRESENTED.

1. Whether it is proper to impose civil liability on a commercial bank as an aider-abettor under Section 10(b) of the Securities Act of 1934 and Rule 10b-5 thereunder because the bank made secured commercial loans (beginning in 1968) to a customer knowing that the customer was also borrowing money on an unsecured basis from employees and others and issuing notes to the lenders without any proof of either knowledge by the Bank that the issuer was committing securities law violations or intent by the Bank to defraud.

2. Whether it is proper to impose civil liability on a commercial Bank as an aider-abettor under Sections 12(1) and 12(2) of the Securities Act of 1933 because the Bank made secured commercial loans (beginning in 1968) to a customer knowing that the customer was also borrowing money on an unsecured basis from employees and others and issuing notes to the lenders without proof of either knowledge by the Bank that the issuer was committing securities law violations or intent by the Bank to violate the securities laws.

3. Whether civil liability for aiding and abetting exists under sections 12(1) and 12(2) of the 1933 Act and under section 10b of the 1934 Act, or whether liability may be predicated only on the express provisions of the acts governing direct liability and liability of controlling persons.

STATUTES AND RULE INVOLVED.

The federal statutes involved here are: Sections 12(1) and 12(2) of the Securities Act of 1933, 15 U. S. C. U. S. C. §§ 77*l*(1) & (2) and Section 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b). The rule involved is Rule 10b-5 promulgated by the Securities and Exchange Commission, 17 C. F. R. § 240.10b-5.

There are constitutional provisions involved herein.

The text of the Statutes and Rule are set forth as Appendix C, at pages A32 through A34.

STATEMENT OF THE CASE.

Consolidated Dressed Beef ("Consolidated") operated an abbatoir, slaughtering beef cattle and selling meat to dealers and food chains and selling meat by-products in Philadelphia and the surrounding area. Prior to 1965, certain members of the Silverberg family owned and operated a meat packing business under the name of Philadelphia Dressed Beef Company, a partnership. In 1965 that partnership purchased all of the stock of Consolidated and continued to do business under the name of Consolidated. Beginning at least in 1955 (and possibly as early as the 1930s) Philadelphia Dressed Beef Company began making payroll deductions from employees' salaries and issuing interest bearing promissory notes to the employees.

Philadelphia Dressed Beef, and later Consolidated, also borrowed money from non-employees, many of whom were friends and relatives of the Silverbergs.

First Pennsylvania Bank was first approached by Consolidated in August, 1968. The Bank requested, received and reviewed various financial statements of Consolidated which included, among other things, information about Consolidated's liabilities to noteholders, as well as to other lending institutions. These notes were explained to the Bank by Consolidated's president as representing loans to Consolidated by employees, friends and relatives of the Silverbergs evidenced by unsecured promissory notes. The Bank accepted this explanation, had no reason to know that notes of this type might be (or might later be held by some lower courts to be) securities and in any event had no knowledge of any securities-law violations by the issuer. The Bank's concern was the quantity and quality of the collateral it held as security for its loans to Consolidated and the adequacy of Consolidated's sources of money. (In that latter connection there is evidence

that the Bank encouraged Consolidated to continue to borrow money from employees and others, and that the Bank account officer knew that the Company did not fully inform all noteholders of the financial condition of Consolidated.)

The Bank first lent money to Consolidated in October, 1968. The loans consisted of an accounts receivable loan, a term loan secured by railroad freight cars, a line of credit secured by liens on trucks, cars, machinery and equipment and by first and second mortgages on Consolidated's real estate. The initial loans totalled more than $3,750,000. The Bank took security interests in certain assets of Consolidated and perfected its security interests under the Pennsylvania Uniform Commercial Code. The Bank's loans to Consolidated began to go bad in September, 1969, when a strike closed the plant for nine weeks. During 1970 and 1971, Consolidated continued to lose money. In January, 1972 the Bank called its loans and liquidated all of Consolidated's assets subject to its security interests. The Bank lost approximately $1,000,000 on its loans to Consolidated. The holders of the unsecured promissory notes lost an additional approximately $400,000.

The named plaintiffs filed this class action in April, 1972, representing all holders of unpaid promissory notes issued by Consolidated. The Complaint was based upon alleged violations of the Securities Act of 1933 and section 10(b) of the Act of 1934 and common-law constructive trust. Jurisdiction was invoked under section 22 of the Securities Act of 1933, 15 U. S. C. § 77v, and section 27 of the 1934 Act, 15 U. S. C. § 77aa. At the close of the plaintiff's case, First Pennsylvania Bank moved for a directed verdict pursuant to Rule 50 of the Federal Rules of Civil Procedure. After extensive oral argument, the

District Court denied the motions for a directed verdict, except as to the common-law constructive trust claim,[1] which was dismissed for lack of pendent jurisdiction. The Court directed a verdict against Consolidated for violating section 12(1) of the 1933 Act[2] and the other securities claims were submitted to the jury, which returned a verdict on liability upon special interrogatories in favor of plaintiff against Consolidated for violating section 12(2) of the 1933 Act and section 10(b) of the 1934 Act, against the individual defendants for violating § 10(b) of the 1934 Act[3] and against the Bank for aiding and abetting violations by Consolidated of both acts.[4] The jury found that the Bank did not directly violate § 10(b) of the 1934 Act.

The parties agreed to the amount of damages, except for three claims which were tried by the Court non-jury. Judgment was entered against First Pennsylvania Bank and all the individual defendants, jointly and severally, in the amount of $152,561.44 in favor of those members of the plaintiff class holding notes issued on or after November 28, 1968, and against Consolidated in the amount of $421,629.30.

First Pennsylvania Bank filed a Motion for Judgment Notwithstanding the Verdict; the other defendants filed a Motion for Judgment N. O. V. or, in the alternative, a New Trial. Plaintiffs filed a Motion to Reinstate Count III and enter Judgment thereon in favor of plaintiffs or, in the alternative, for a new trial on Count III. After oral argument, the Court, by Memorandum and Order dated April 27, 1977, granted First Pennsylvania Bank's Motion and

1. Count III of the Complaint.
2. Count I of the Complaint.
3. Count II of the Complaint.
4. Count IV of the Complaint.

denied the Motion of the other defendants as well as plaintiff's Motion. Plaintiffs and the individual defendants appealed and First Pennsylvania Bank filed a cross-appeal with respect to the court's denying pendent jurisdiction of the common-law claim.

The Court of Appeals, by its Opinion dated June 14, 1978, reversed the district court's judgment N. O. V. in favor of the Bank on the securities claims, reinstating the jury's verdict and affirming the district court's dismissal of the plaintiff's pendent state claim and its refusal to grant judgment on that claim.

REASONS FOR GRANTING THE WRIT.

Certiorari should be granted to consider whether civil liability for aiding and abetting is appropriate under sections 12(1) and 12(2) of the 1933 Act and section 10(b) of the 1934 Act, which was specifically noted as not considered or decided in *Ernst & Ernst v. Hochfelder*, 425 U. S. 185, n. 7 at 192 (1976). *Certiorari* should be granted to consider whether the Third Circuit's standard of liability is inconsistent with *Ernst & Ernst v. Hochfelder*, since it imposes liability even though the Bank acted without actual intent to deceive, manipulate or defraud, as specifically found by the jury. *Certiorari* should be granted to consider whether a commercial bank making secured loans had a duty (in 1968) to police the manner in which its customer borrowed money from friends and employees.

The decision of the Third Circuit, if it is to stand as law, sets standards which apply to all commercial lending institutions who lend money to issuers and affects many lenders, many borrowers and huge sums of money. The effect of this decision therefore far transcends the individual litigants here.

The decision below is fundamentally at odds with *Ernst & Ernst v. Hochfelder*, where this Court limited the scope of private actions under section 10(b) and Rule 10b-5 by requiring the plaintiff to prove scienter[5] on the part of the defendant. Although the plaintiff in *Hochfelder* sought compensation from Ernst & Ernst on the ground that the auditor aided and abetted the fraud, this Court decided the case as one of direct liability, refraining from considering aiding and abetting liability:

> In view of our holding that an intent to deceive, manipulate, or defraud is required for civil liability under § 10(b) and Rule 10b-5, we need not consider whether civil liability for aiding and abetting is appropriate under the section and the Rule, nor the elements necessary to establish such a cause of action. 425 U. S. 192 n. 7.

5. The Court defined scienter as an "intent to deceive, manipulate, or defraud." 425 U. S. at 193.

The decision of the Court of Appeals raises an important question of federal law which has not been, but should be, settled by the Supreme Court. There should be no liability for aiding and abetting by inaction alone, especially where the alleged aider-abettor conducts transactions in the ordinary course of its business. This is in keeping with the recent trend by the Supreme Court toward limiting access to the federal courts by private parties in securities actions under the 1934 Act. In *Blue Chip Stamps v. Manor Drug Stores*, 421 U. S. 723 (1975), this Court limited the class of private plaintiffs in damage actions under section 10(b) and Rule 10b-5 by affirming the *Birnbaum*[6] rule, requiring a plaintiff to be either a purchaser or seller of securities. The Court observed that

> [W]hile much of the development of the law of deceit has been the elimination of artificial barriers to recovery on just claims, we are not the first court to express concern that the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good. 421 U. S. at 747-48.

In *Cort v. Ash*, 422 U. S. 66 (1975), this Court declined to imply a private cause of action for a shareholder who had brought suit derivatively on behalf of a corporation. And in *TSC Industries, Inc. v. Northway, Inc.*, 426 U. S. 438 (1976), this Court unanimously held that an omission

6. *Birnbaum v. Newport Steel Corp.*, 193 F. 2d 461 (2d Cir.), *cert. denied*, 343 U. S. 956 (1952).

from a proxy solicitation is "material" for the purposes of section 14(a) of the 1934 Act only "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote," 426 U. S. at 449, thereby adopting a standard of materiality requiring a relatively high threshold of proof to establish liability. In *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U. S. 232 (1976), section 16(b), which allows a corporation to recover any profits its insiders realize from a short-term purchase and sale of the company's securities, was held to apply only to those stockholders whose securities holdings qualified them as "insiders" before the initial short-term purchase.

Likewise, in *Hochfelder*, this Court expressed its concern about the growing class of possible private plaintiffs in securities cases. 425 U. S. at 191 n. 33. Respondents in the instant case did not prove, nor did the jury find, any actual intent to deceive, manipulate or defraud by the Bank, all of which are now required. Therefore, *certiorari* should be granted.

The Third Circuit applied an erroneous standard for the aider-abettor's knowledge of a securities violation, citing *Gould v. American-Hawaiian Steamship Co.*, 535 F. 2d 761 (3d Cir. 1976), which stated in dictum [7] that the knowledge required for aiding and abetting can be actual or constructive, 535 F. 2d at 780. That standard does not apply, however, to a 10b-5 case, since *Gould* involved a false or misleading proxy statement in violation of section 14(a) of the 1934 Act, 15 U. S. C. A. 78a(n), where the proper standard of liability is negligence, 535 F. 2d at 777.

7. The dictum in *Gould* (that knowledge of the wrongful act can be constructive) is inconsistent with the decision of the Supreme Court of the United States in *Ernst & Ernst* (decided only ten days earlier than *Gould*, on March 30, 1976).

The result of the Third Circuit's extension of securities law liability to the Bank in this case is particularly unjust since the Bank has already lost more on its loans than the class of lenders it is now required to compensate.

CONCLUSION.

For all the reasons set forth above, a Writ of Certiorari should be granted to review the opinion and judgment of the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

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Dated: September 8, 1978

APPENDIX A.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 77-1935
77-1936
77-1937

GEORGE R. MONSEN; JOSEPH J. OBERMEYER; JAMES DELGADO; JOSEPH COSGROVE; ROBERT COSGROVE; and JUSTIN ROSENSTOCK and EVA ROSENSTOCK as Trustees for BENJAMIN ROSENSTOCK; JUSTIN ROSENSTOCK and EVA ROSENSTOCK as Trustees for RENEE ROSENSTOCK; JUSTIN ROSENSTOCK as Parent and Natural Guardian of BENJAMIN ROSENSTOCK; JUSTIN ROSENSTOCK as Parent and Natural Guardian of ELI ROSENSTOCK; JUSTIN ROSENSTOCK as Parent and Natural Guardian of RENEE ROSENSTOCK; CLAUDIA ROSENSTOCK; and ELEANOR SCHWARTZ

v.

CONSOLIDATED DRESSED BEEF COMPANY, INC.; SAMUEL SILVERBERG; SIDNEY SILVERBERG; EDWARD SILVERBERG; MICHAEL SILVERBERG; REUBEN SILVERBERG; NATHAN SILVERBERG; ALAN SILVERBERG; and FIRST PENNSYLVANIA BANKING AND TRUST COMPANY

GEORGE R. MONSEN, et al.,
Appellants in No. 77-1935
SAMUEL SILVERBERG, et al.,
Appellants in No. 77-1936
FIRST PENNSYLVANIA BANK, N. A.,
Appellant in No. 77-1937

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

D. C. Civil Action No. 72-799

Argued March 28, 1978

Before ADAMS, VAN DUSEN, and ROSENN, *Circuit Judges*

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Opinion of the Court

(Filed June 14, 1978)

ROSENN, *Circuit Judge*

In these appeals we are called upon primarily to determine the propriety of imposing sanctions on a lending institution as an aider-abettor because of that institution's actions in connection with a loan to a borrower who violated the federal securities laws. We confront the perplexing dilemma of ascertaining when the legitimate business relationship between a lender and its borrower leaves the realm of propriety and enters the domain of proscribed conduct.

This conundrum arises from a class action brought on behalf of the holders of unregistered securities—promissory notes—issued by the Consolidated Dressed Beef Company, Inc. ("Consolidated"), a company whose stock was owned by the Silverberg brothers and Michael and Alan Silverberg, the sons of one of the brothers, (collectively "Silverbergs"), which borrowed money from the First Pennsylvania Bank, N. A. ("Bank"). Plaintiffs, former employees of Consolidated and their families, who had made loans on the promissory notes from the company, alleged direct violations of sections 12(1) and 12(2) of the Securities Act of 1933 [1] and section 10b of the Act of 1934 [2] by Consolidated,[3] also violations of both acts by the Silver-

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1. 15 U. S. C. §§ 77*l*(1) & (2) (1976). Violations of section *l*(1), prohibiting the offer or sale of an unregistered security, and section *l*(2), prohibiting the offer or sale of any security containing untrue or materially misleading omissions of fact by means of interstate commerce, subject the seller or offeror to liability to the purchaser of the security.

2. 15 U. S. C. § 78j(b) (1976). This section prohibits the use of any "manipulative or deceptive device or contrivance" in connection with the purchase or sale of a security and subjects the fraudulent seller or purchaser to personal liabiltiy.

3. In count I of the complaint, plaintiffs allege that the notes issued to them as members of the class by Consolidated constituted a sale of securities, required to be registered under the Securities Act of 1933, 15 U. S. C. § 77b(1) (1976), but that they were issued

bergs as controlling persons,[4] and violations of both acts by the Bank as an aider-abettor to Consolidated and the Silverbergs.[5] Plaintiffs also sought recovery from the Bank on the basis of a pendent state claim predicated upon a common law constructive trust theory alleging the Consolidated is insolvent and that the Bank has taken control of all of Consolidated's assets and applied the proceeds to its debt.[6] After completion of the plaintiff's case, the trial judge dismissed the pendent state claim and the jury found for plaintiffs against all of the defendants on the remaining securities claims and awarded damages. On post-trial motions, the district court denied the Silverbergs' requests for judgment notwithstanding the verdict ("n. o. v."), denied both plaintiffs' and the Bank's request for judgment on the dismissed state claim, and granted the Bank's request for judgment n.o.v. on all counts. We affirm in part and reverse in part.

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3. (Cont'd.)
unregistered and with untrue statements of material fact, in violation of §§ 77*l*(1) & (2) of 15 U. S. C. In count II of the complaint, plaintiffs allege that Consolidated had induced them to purchase securities by means of fraudulent omissions and erroneous statements of fact in violation of section 10b of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b) (1976) and rule 10b-5 promulgated thereunder, 17 C. F. R. § 240.10b-5 (1977).

4. The Silverbergs were alleged to be derivatively liable for Consolidated's securities violations in counts I and II of the complaint, by virtue of their control over a primary violator of the securities law. *See* 15 U. S. C. § 77o (1976) ("Every person who . . . controls any person liable under sections 77k or 77*l* of this title shall be liable . . . to the same extent as the controlled person") (1933 Act); 15 U. S. C. § 78t (1976) (liability for control of any violator of the 1934 Act).

5. Count IV of the complaint.

6. Count III of the complaint.

I.

In these appeals from a grant and denial of judgment n. o. v., we must view the evidence in the light most favorable to the party that secured the verdict, drawing all reasonable inferences that the jury might have drawn to support its decision. *Thomas v. E. J. Korvette, Inc.*, 476 F. 2d 471, 474 (3d Cir. 1973). An analysis of the record reveals the following facts, drawn from the pre-trial factual stipulations of the parties and a close reading of the testimony adduced at trial.

Consolidated is a now defunct Pennsylvania corporation which was until January of 1972, in the business of slaughtering, dressing, selling, and delivering meat and meat products. Its officers and directors are members of the Silverberg family. Prior to 1965, certain of the Silverbergs owned and operated a meat packing business under the name of Philadelphia Dressed Beef Company, a partnership, and in 1965 that partnership purchased all of the stock of Consolidated, continuing business under that name.

The initial payroll borrowing program was commenced by Philadelphia Dressed Beef Company by 1955—possibly as early as the 1930's—and then continued by Consolidated when it was acquired. Payroll deductions were made from the company's employees' salaries and promissory notes were issued in exchange. This arrangement was voluntary on the part of the employees who could elect to accept full salary instead of the notes. Any employee choosing to participate, however, was asked to sign a company prepared authorization form. Records were kept by the company of the amount of payroll deductions authorized by each participating employee.

At the end of three months of these deductions, the company issued a note in the name of the employee lender

for the face value of the total of the payroll deductions made for the preceding quarter. These notes called for the repayment of the principal after five years and provided for the payment of interest to the employee every three months until maturity.

At first, the notes bore interest at a rate of seven percent per year, but subsequently the interest rate was raised to eight percent per annum. Employees participating in the program had the option of receiving interest quarterly or having the company accumulate it as consideration for additional notes. In 1970, after pressure from the noteholders, Consolidated accelerated the maturity date on the notes from five years to either one or two years. Employees enjoyed the option of accepting one-year notes, bearing an interest rate of one percent less than the two-year notes, or of accepting two-year notes.

At the same time, Consolidated had also instituted a parallel note program for non-employees and for those employees who lent the company supplementary funds outside of payroll deductions. Interest on these notes was paid either monthly or yearly and could also, at the election of the noteholder, be accumulated in return for additional notes.

Testimony at trial revealed that none of the noteholders were given financial information about Consolidated prior to their loans to the company. It is undisputed that the loans were generated out of employee loyalty to Consolidated and confidence in the Silverbergs' ability to manage the company. The notes were never registered under either state or federal law.

Consolidated kept detailed records on the progress of both the employee and non-employee note programs, first by hand and later by computer. Printouts eventually contained information showing the total deductions from each employee's paychecks, listed as a "savings" programs, as

well as showing data from the non-employee plans. This information, payment for the notes, and the notes themselves, all travelled in interstate commerce or through the mails.

By August of 1968, the company had continuously conducted its note program without ever missing a payment to its lenders, although it had accumulated a debt of several hundred thousand dollars through the program. At this time, however, the meat industry was beginning to change substantially. To successfully compete under these changed circumstances, Consolidated required additional funds. It therefore communicated with the Bank to arrange for supplementary financing. The Bank requested and received various financial data from Consolidated, including financial reports from 1966, 1967, and 1968 which contained information about the company's extensive liabilities incurred through the note programs. These reports were reviewed and analyzed by officers and employees of the Bank.

In September of 1968, John C. Wilson, manager of the Bank's branch office with which Consolidated did business, was requested by the Bank to pursue the Consolidated loan request. He spoke with Samuel Silverberg by telephone about conditions at Consolidated's plant, reviewed the company's financial statements, and attended meetings at and toured Consolidated's plant.

Further meetings also were held in Wilson's office. At these meetings, financial statements containing entries describing the note program were discussed. Wilson asked for an explanation of these entries, and in response, Consolidated furnished the Bank with detailed statements listing each of the employee and non-employee lenders. Consolidated also furnished the Bank sample copies of the notes, forms, and sufficient additional information to in-

form the Bank that the noteholders were primarily Consolidated's employees, their families, and friends of the Silverbergs, all of whom had loaned funds to Consolidated in reliance on the Silverbergs' ability to conduct a successful business. On September 18, 1968, following the delivery of this detailed information by Consolidated, the Bank entered into a financing arrangement with the company.

Under the terms of the lending agreement, the Bank became a secured creditor and the noteholders' obligations were effectively subordinated. The Bank was also given the power to restrict Consolidated from borrowing from any source other than the Bank. The record, however, reveals that the Bank not only did not bar additional financing elsewhere, but actually encouraged the continuation of financing through the note program. The Bank had informed Consolidated of its desire to have Consolidated raise funds through unsecured promissory notes, because it provided needed cash to the company and created assets from which the Bank could satisfy its debt. Consolidated, with the Bank's knowledge, never informed the noteholders that their increased investments in the company was subordinated to the Bank's security interest. Yet, knowing of this lack of disclosure and that the noteholders did not have adequate financial information about Consolidated, and that they had invested solely on faith in the Silverbergs, the Bank permitted—even encouraged—additional utilization of the note program.

Following consummation of the lending agreement between the Bank and Consolidated, the Bank regularly received monthly profit and loss figures, quarterly and semi-annual financial statements, and yearly reports from Consolidated. The Bank was keenly aware of the detriorating condition of the company due to marketing and

supply changes in the industry,[7] but it nonetheless refused to curb Consolidated's use of the note program.

By January of 1972, Consolidated's position was so precarious that the Bank was forced to seize control of the company's assets. Consolidated was prevented by arrangement with the Bank from paying any interest on its notes or honoring them as they matured. The Bank proceeded to liquidate Consolidated's assets and to apply the proceeds to the company's outstanding debt to the Bank. Although the Bank's loan was only partially satisfied none of the noteholders received any payment whatsoever after 1972 and their debt remains unsatisfied.

At trial the following legal conclusions were also stipulated: (1) the notes on which the plaintiffs brought suit were securities under the Securities Acts of 1933 and 1934; (2) the notes were not registered under federal or state laws; (3) interstate commerce was used in transporting the notes; and (4) Consolidated was liable for the face amount of each of the notes. Prior to trial, the district court ruled as a matter of law that Consolidated had violated section 12(1) of the Securities Act of 1933, 15 U. S. C. § 77*l*(1) (1976) by its failure to register the notes.

With this factual background, the case was submitted to the jury on written interrogatories. The jury found

7. Although 1968 had been a profitable year for Consolidated, in 1969, it began to suffer dramatic losses. In 1969, a strike occurred during the company's principal profit season, and had the effect of seriously eroding profits. Similarly, changes in the meat industry also began to affect the company's financial condition.

In 1970 the Chicago stockyards closed, making it difficult for Consolidated to purchase live cattle, the mainstay of its business. As a result, the company was forced to discontinue slaughtering and to buy dressed carcasses, which both decreased profit margins and left Consolidated with a large overhead for the unused portion of its plant.

In the nine-month period ending July 31, 1971, Consolidated lost $824,000. The Bank knew of these losses by virtue of financial statements from Consolidated.

Consolidated liable under section 12(2) of the 1933 Act, 15 U. S. C. § 77*l*(2) (1976) and section 10b of the 1934 Act, 15 U. S. C. § 78j(b) (1976), because of its misleading statements and omissions in connection with the note program. The jury also found the Silverbergs liable as controlling persons on the securities counts and the Bank liable as an aider-abettor to Consolidated for its securities violations. The jury exonerated the Bank of any direct liability under section 10b of the 1934 Act. The jury returned a verdict against Consolidated for $421,639.30 and against the Bank and the Silverbergs for $152,561.44.

The Bank requested judgment n. o. v. on all counts including the dismissed pendent state claim; it stated that it was entitled to judgment as a matter of law due to the insufficiency of proof of any securities violation. The Silverbergs also moved for judgment n. o. v. on all counts of liability against them. The plaintiffs requested that the dismissed state claim be reinstated and that judgment be entered in their favor.

The district court granted the Bank's motion for judgment n. o. v. on the securities counts, stating that the evidence was insufficient to provide aiding and abetting. All of the other motions were denied. Plaintiffs appeal the grant of judgment n. o. v. in favor of the Bank; the Silverbergs appeal the denial of their motion for judgment n. o. v.; both the Bank and the plaintiffs appeal the dismissal of the pendent state count and the refusal of the court to grant a judgment on the merits of that cause of action. We consider each of these claims seriatim.

II.

Plaintiffs appeal from the grant of judgment n. o. v. in favor of the Bank on all of the counts of the complaint alleging aiding and abetting of securities violations by the

Bank. To sustain a charge of aiding and abetting, the plaintiffs have the burden of establishing: (1) that there has been a commission of a wrongful act—an underlying securities violation; (2) that the alleged aider-abettor had knowledge of that act; and (3) that the aider-abettor knowingly and substantially participated in the wrongdoing. *Gould v. American-Hawaiian Steamship Co.*, 535 F. 2d 761, 779 (3d Cir. 1976); *Rochez Brothers, Inc. v. Rhoades*, 527 F. 2d 880, 886 (3d Cir. 1975) ("*Rochez II*") (stating the third element alternatively as "substantial assistance in effecting" the wrongful act); *Landy v. Federal Deposit Insurance Corp.*, 486 F. 2d 139, 162-63 (3d Cir. 1973), *cert. denied*, 416 U. S. 960 (1974).[8]

Knowledge of the underlying violation is a critical element in proof of aiding-abetting liability, for without this requirement financial institutions, brokerage houses, and other such organizations would be virtual insurers of their customers against security law violations. Culpability of some sort is necessary to justify punishment of a secondary actor and mere unknowing participation in another's violation is an improper predicate to liability. *See* Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, In Pari Delicto, Indemnification, and Contributions*, 120 U. Pa. L. Rev. 597, 638 (1972).

In *Landy v. Federal Deposit Insurance Corp., supra*, we indicated that the aider-abettor's knowledge of a securities violation must be actual. However, in *Gould v. American-Hawaiian Steamship Co., supra*, we stated that the "requirement of knowledge may be less strict where the alleged aider and abettor derives benefits from the wrongdoing." 535 F. 2d at 780. Nevertheless, even in such a situation, "the proof offered must establish con-

8. *See* Woodward v. Metro Bank of Dallas, 522 F. 2d 84, 95 (5th Cir. 1975); SEC v. Coffey, 493 F. 2d 1304, 1316 (6th Cir. 1974).

scious involvement in impropriety or constructive notice of intended impropriety." *Id.*[9] Such involvement may be demonstrated by proof that the alleged aider-abettor "had general awareness that his role was part of an overall activity that is improper." *SEC v. Coffey*, 493 F. 2d 1304, 1316 (6th Cir. 1974), *accord, Gould v. American-Hawaiian Steamship Co., supra*, 535 F. 2d at 880. In determining this awareness, "the surrounding circumstances and expectations of the parties are critical." *Woodward v. Metro Bank of Dallas*, 522 F. 2d 84, 95 (5th Cir. 1975).[10]

Equally important as knowledge in establishing an aider-abettor's liability, is proof of his substantial assistance or participation in the primary securities violation. The securities laws comprehend that mere knowledge of a violation alone, without assistance or a duty to disclose the violation, is not an actionable wrong. *See* Ruder, *supra*, 120 U. Pa. L. Rev. 644. Nor have courts extended vicarious liability where the secondary defendant's conduct is nothing more than inaction. Such inaction, however, may provide a predicate for liability where the plaintiff demonstrates that the aider-abettor *consciously* intended to assist in the perpetration of a wrongful act. *Gould v. American-Hawaiian Steamship Co., supra*, 535 F. 2d at 780; *Rochez II, supra*, 527 F. 2d at 889.

9. It has been suggested by the Fifth Circuit that when an alleged aider-abettor conducts what appears to be no more than a transaction in the ordinary course of business, the degree of knowledge must be higher than in the typical case. Woodward v. Metro Bank of Dallas, *supra*, 522 F. 2d at 95. In the former situation, the court suggests that no liability may be found unless there is "clear proof of intent to violate the securities law." *Id.* at 97.

10. Analysis of aiding and abetting knowledge unavoidably "harks back to the nature of the security that is the object of the transaction." Woodward v. Metro Bank of Dallas, *supra*, 522 F. 2d at 95. In the case of publicly issued stock the alleged aider-abettor may be more easily charged with knowledge of the circumstances surrounding the sale of a security than in the privately sold security. *Id.*

It sometimes may be difficult for a court to reach a decision as to whether an alleged aider-abettor's conduct is sufficient to constitute substantial assistance or participation in a wrongful act. We therefore have pointed to the Restatement of Torts § 876 (1937) (liability for contributory tortfeasors) [11] for guidance to district courts for making that determination. The Restatement instructs the trier of fact to consider the following factors in determining whether a defendant's conduct constitutes substantial assistance: (1) the amount of assistance given by the defendant, (2) his presence or absence at the time of the tort, (3) his relation to the other person, and (4) his state of mind. *Landy v. Federal Deposit Insurance Corp., supra*, 486 F. 2d at 162.

In applying the above standards to the proof adduced by plaintiffs at trial, the district court concluded that the evidence was insufficient to support the jury's finding of aiding and abetting by the Bank and that the verdict should be reversed. The court concluded, first, that the Bank rendered no assistance to the securities violation, second, that the Bank never participated in the sales and was absent at the time they occurred, third, that the Bank made no representations to the buyers of the notes and owed them no legal duty of disclosure, and fourth, that although the Bank gave limited encouragement to Consolidated to continue the note program, the evidence failed to

11. Section 876 of the Restatement provides in pertinent part:

§ 876 Persons Acting in Concert

For harm resulting to a third person from the tortious conduct of another, a person is liable if he

* * *

(b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself,

* * *

show any intention by the Bank to further a securities violation.[12]

Plaintiffs claim that the district court's review of the evidence was unduly narrow, that the court incorrectly applied the standards governing aiding-abetting liability, and that therefore the verdict must be reinstated. Plaintiffs assert that this overly restrictive approach to the evidence caused the court to erroneously avoid the cardinal principal of review of a jury's verdict—that judgment n.o.v. should not be awarded as long as "there is conflicting evidence or there is insufficient evidence to make a 'one-way' verdict proper." *Thomas v. E. J. Korvette, Inc., supra,* 476 F. 2d at 474. We agree.

There is no question that the record clearly establishes the first element of proof of aiding-abetting. Consolidated committed underlying securities violations of sections 12(1) & (2) of the 1933 Act and of section 10b of the 1934 Act. (*See* pp. A9-A10, *supra.*) As to the second and third elements, the district court, in its opinion disposing of the post-trial motions, stated that the evidence showed: (1) that the note program was instituted on behalf of friends and employees of the Silverbergs, (2) that the Bank had knowledge of the promissory note program and should have known of its illegality, (3) that the Bank as a secured lender encouraged the note program to continue, thus improving the Bank's position at the expense of the noteholders, and (4) that the Bank had the authority to require Consolidated to discontinue the note program. Taking the evidence in the light most favorable to the prevailing party, the record sufficiently supports the jury's findings that the Bank had knowledge of the underlying securities violations and substantially assisted or participated in their accomplishment.

12. The district court also indicated its concern that the evidence failed to prove scienter by the Bank in its aid of Consolidated's securities violations as required by Ernst & Ernst v. Hochfelder, 425 U. S. 185 (1976), in a private cause of action for damages. We consider the sufficiency of the Bank's scienter at n. 17, *infra.*

Evidence of Knowledge of the Primary Violation

Olinto R. Serafini, who worked for Philadelphia Dressed Beef Company and for Consolidated from 1942 to 1972 as its bookkeeper, office manager, and comptroller, testified that the Bank was advised that funding from the note program had continuously increased over the years prior to the Bank's loan, that Consolidated had begun to lose substantial amounts of money, that no financial information was given to the noteholders, and that the noteholders never received information of the declining profit margins of Consolidated.

Wilson, manager of the Bank's branch dealing with Consolidated's loan, substantiated this testimony. He stated: the Bank had extensive knowledge of the note program; the Bank understood that the funds derived from this program were lent to Consolidated principally on confidence in the Silverbergs and faith in the company; the transactions were not at arm's length; the securities were not registered;[13] the Bank, with assistance from its own securities analyst, had discussed the possibility of Consolidated making a public issue of stock; and the Bank considered the noteholders as investors. Ralph Henry, Wilson's superior at the Bank, confirmed that the Bank knew that the funds produced by the note program were obtained on faith, without financial information.

13. The district court held that the Bank should have known that the securities were required to be registered from its inspection of the notes, the financial statements supplied by Consolidated, and the Bank's familiarity with the securities laws.

Samuel Silverberg, the President of Consolidated, testified that the Bank was told that the noteholders had lent money to Consolidated solely on the basis of trust and that such lenders were provided with no financial information about the company.[14] In critical testimony, he revealed that the Bank had demanded subordination of the note program and guarantees of its continuation, with full understanding that the company could not disclose the junior status of the notes to the noteholders and expect them to continue to lend funds to the company.[15]

---

14. Samuel Silverberg's testimony concerning the Bank's knowledge that the noteholders were given no financial advice about Consolidated prior to their advances was as follows:

> Q: In other words, these [the noteholders] were people who had faith and trust in you, your family, and your family's company, isn't that right?
>
> A: That's correct.
>
> • • •
>
> Q: And, this was made known to the bank when they inquired about this plan, wasn't it, that this is the kind of person who was listed [in the statements sent to the Bank]?
>
> A: That's correct.
>
> Q: It was also made known that the basis of the investment was trust and confidence, and not financial, technical information, isn't that correct?
>
> A: That's correct. There was no technical, financial information given, to the best of my knowledge.
>
> Q: And, this was made known in your discussions concerning [the supporting material for the loan]?
>
> A: That's correct.

15. Silverberg testified that he notified the Bank of Consolidated's intention not to fully disclose to the noteholders their junior position and the terms of the Bank's loan to the company. He stated:

> They [the Bank] wanted to know what the notes were. I told them strictly promissory notes. . . . A request was made that the notes become subordinated to any bank debt. *I told them that could not be done without alienating all the noteholders and having them disappear off the scene.* And, after that kind of discussion, it was finally agreed we'd just leave the notes stay as notes.

(Emphasis supplied.)

Evidence of "Substantial Assistance"

Bank officers Wilson and Henry testified that the Bank desired that the note program be subordinated to its position and that the Bank encouraged Consolidated to ensure the program's continuation. In fact, it may be fairly stated that the Bank attempted to extract a promise from Consolidated that the program would continue.[16] They also testified that the Bank had the power to prevent further borrowing by Consolidated from the noteholders, but that the Bank never exercised it.

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16. Mr. Wilson's testimony concerning the Bank's insistence upon the continuation of the note program is as follows:

> Q: Isn't it . . . true that it was your concern that the cash and capital of [Consolidated] not be depleted by a large outflow of money represented by those notes?
>
> A: Yes.
>
> Q: And, isn't it true that you told Mr. Silverberg that it was the bank's desire that the practice or the past history of the notes steadily increasing continued to be the case with this company?
>
> A: Yes.
>
> • • •
>
> Q: And, in fact, you encouraged Mr. Silverberg to continue to receive funds on this basis, because it was a very economic way for the company to receive funds on an unsecured basis, isn't that correct?
>
> A: Yes.

Mr. Henry, Wilson's superior at the Bank confirmed Wilson's testimony:

> Q: Did you and Mr. Wilson discuss whether the company should be encouraged to continue or expand the issuance of such notes in return for cash?
>
> A: Yes.
>
> Q: What was that discussion?
>
> A: We encouraged the company to do this.
>
> • • •
>
> Q: Were you aware of whether the bank, through Mr. Wilson or yourself or anyone else, asked for the company's assurance that it would continue to [do] so?
>
> A: I assume we did.

Sufficiency of Evidence of Aiding-Abetting

We believe that this evidence, taken in the light most favorable to the verdict winner, is adequate to support the jury's finding of the Bank's liability as an aider-abettor. At a minimum, the evidence reveals: the Bank was well informed about the note program; it knew that the notes were unregistered; it either knew, or as a major metropolitan banking institution should have known, of the registration requirement for the notes; it knew that the noteholders were receiving no financial information, but were trading on faith in the Silverbergs; it knew that Consolidated would not reveal either its financial difficulties or the junior status of the promissory notes to the noteholders; and with this knowledge the Bank demanded subordination of the notes and actively encouraged Consolidated to continue the note program. It is true that knowledge alone of the note program would have been an insufficient predicate for aiding and abetting liability against the Bank. Similarly, had the Bank merely required the continuation and subordination of the note program without knowledge of the Silverbergs' intent not to disclose the subordination to the noteholders, liability might not have been established. This combination of knowledge and action by Bank, however, is sufficient evidence to support the jury's verdict on the Bank's liability.

The district court held the proof insufficient to make out a violation of the securities laws because it contained no evidence of an intent by the Bank to assist a primary violation of securities law.[17] In determining the Bank's

17. The court also held that the Bank rendered no assistance to any securities violation, that it did not participate and was not present at the sale of the securities, and that it made no representations to the buyers and was under no duty to do so. We believe that these conclusions are erroneous, as the evidence shows the Bank's active role in the continuation of the note program. It

intent, however, the district court did not consider the critical fact that the Bank *knew* that the company would not reveal the Bank's superior position to the noteholders, and in the face of that position nonetheless insisted upon the continuation of the note program. With Consolidated in a deteriorating financial condition, the Bank's requirement of assurances of the continuation of an unregistered security program knowing of Consolidated's intention not to disclose the weaknesses of the program, is tantamount to proof that the Bank's conduct was a major substantive factor in aiding the fraud against the noteholders.[18]

17. (Cont'd.)
monitored the program monthly and made it clear as an initial matter that the program would have to continue if Consolidated were to obtain a bank loan. Although the Bank itself was not present at the sale of the securities, it had full information on each sale and it required Consolidated to inform it of the specifics of the expanding note program. Finally, it is true that the Bank had no direct duty to the purchasers of the notes, but it was not merely an innocent third party. Rather, it enhanced its position at the expense of the noteholders with knowledge of Consolidated's deception of the noteholders.

The district court also stated its belief that the record insufficiently established the Bank's scienter in Consolidated's violation of section 10b of the 1934 Act. Scienter is "a mental state embracing intent to deceive, manipulate or defraud." Ernst & Ernst v. Hochfelder, *supra*, 425 U. S. at 194 n. 12. Without reaching the issue of whether the Bank's reckless disregard of Consolidated's deception may constitute scienter, we hold that the Bank's knowledge of the company's intention not to disclose the subordinated position of the noteholders and the Bank's intention to take advantage of the noteholders' junior status is sufficient proof of manipulative intent to fulfill the scienter requirement and thereby support the Bank's aiding and abetting liability.

18. This case is thus distinguishable from Woodward v. Bank of Dallas, *supra*. In *Woodward*, plaintiff, an accommodation maker of a borrower of the bank, sued the bank as an aider-abetter of the borrower's securities violation—a duty and failure to disclose to the plaintiff the borrower's hopeless financial condition. The bank had pressured the borrower to find a guarantor for an additional loan, but there was no evidence that the bank had a continuing understanding of its borrower's intention to withhold information from

Therefore, the Bank cannot be heard to complain that it did not substantially assist in Consolidated's violations. It may be that had we been the triers of fact in this case we might not have held the Bank liable on this record, but the evidence does provide adequate support for the *jury's* verdict and under our limited role on appeal we cannot usurp their function.

III.

The Silverbergs assert that the district court erred in denying their motion for judgment n.o.v. on the securities violations. They request that we separate the evidence of liability as to each of the Silverbergs individually. We have viewed the evidence separately, but we nonetheless find sufficient evidence to support the verdict against each of them.

It was stipulated at trial that all seven of the Silverbergs were officers, directors, and shareholders of Consolidated and that they were in fact the only officers, directors, and shareholders of the company. Furthermore, Serafini, Consolidated's comptroller, testified that all of the Silverbergs constituted the board of directors of the company and that each was present at the meetings of the company in which the note program was discussed. He

18. (Cont'd.)
others from which it sought funds. The court concluded on such facts that no liability would be justified. As is evident, in *Woodward* the plaintiff did not establish the bank's knowledge of its borrower's fraud. That lack of knowledge is the critical difference between that case and the instant one. The same distinction eliminates the problem of aider-abettor liability for a bank envisioned by Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnifaction, and Contribution*, 120 U. Pa. L. Rev. 597, 630-31 (1972) (fear of extension of liability to bank as aider-abettor when bank has no knowledge of underlying violation), cited by the *Woodward* court. Woodward v. Metro Bank of Dallas, *supra*, 522 F. 2d at 96.

specifically recollected his presence at meetings in which the programs were described and discussed in full detail among all of the Silverbergs. He stated that so far as he knew, there were no parts of the program unknown to any of them.

Such knowledge placed each of the Silverbergs on notice as to Consolidated's violations of the securities acts and therefore subjected them to liability, as controlling persons, for the company's violations "to the same extent" as the company. 15 U. S. C. §§ 77o, 78t (1976). Under *Rochez II*, *supra*, 527 F. 2d at 890, a director may not be found liable unless he has culpably participated in the controlled person's unlawful activity. The knowledge of each of the Silverbergs of the dynamics of the note program and their presence at board meetings at which the program was considered is sufficient proof of their culpability to support the jury's verdict. We affirm the district court's denial of the Silverbergs' motions for judgment n.o.v.

Both the plaintiffs and the Bank contend that the pendent state claim was erroneously dismissed by the trial court. Each suggests that judgment be entered in its favor as a matter of law. Our review of the district court's dismissal of this claim is confined to determining whether the court abused its discretion. Under that standard we find no reversible error.

The district court dismissed plaintiffs' pendent state claim asking for declaration of a constructive trust in its favor of Consolidated's assets seized by the Bank because the court perceived a possibility of jury confusion between that issue and the federal securities claims. In *United Mine Workers v. Gibbs*, 383 U. S. 715 (1966), the Supreme Court indicated that "there may be reasons . . . such as the likelihood of jury confusion . . . that would justify" dismissal of pendent state claims. *Id.* at 726-27; *see Robinson*

v. Penn Central Co., 484 F. 2d 553, 556 (3d Cir. 1973) (court has discretion to dismiss pendent state claim because of judicial economy and fairness to litigants even after trial has begun). Following that principle, we find no abuse of discretion by the trial court in its dismissal of the plaintiffs' state claim and express no view on the merits of their cause of action.

IV.

To recapitulate, we conclude:

(1) The district court's judgment n.o.v. in favor of the Bank on the securities claim will be reversed and the jury's verdict reinstated.

(2) The denial of the Silverbergs' motions for judgment n.o.v. will be affirmed.

(3) The district court's dismissal of the plaintiffs' pendent state claim and its refusal to grant judgment on that claim to the plaintiffs or the Bank will be affirmed.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 77-1935
77-1936
77-1937

GEORGE R. MONSEN; JOSEPH J. OBERMEYER; JAMES DELGADO; JOSEPH COSGROVE; ROBERT COSGROVE; and JUSTIN ROSENSTOCK and EVA ROSENSTOCK as Trustees for BENJAMIN ROSENSTOCK; JUSTIN ROSENSTOCK and EVA ROSENSTOCK as Trustees for RENEE ROSENSTOCK; JUSTIN ROSENSTOCK as Parent and Natural Guardian of BENJAMIN ROSENSTOCK; JUSTIN ROSENSTOCK as Parent and Natural Guardian of ELI ROSENSTOCK; JUSTIN ROSENSTOCK as Parent and Natural Guardian of RENEE ROSENSTOCK; CLAUDIA ROSENSTOCK; and ELEANOR SCHWARTZ

v.

CONSOLIDATED DRESSED BEEF COMPANY, INC.; SAMUEL SILVERBERG; SIDNEY SILVERBERG; EDWARD SILVERBERG; MICHAEL SILVERBERG; REUBEN SILVERBERG; NATHAN SILVERBERG; ALAN SILVERBERG; and FIRST PENNSYLVANIA BANKING AND TRUST COMPANY

GEORGE R. MONSEN, et al.,
Appellants in No. 77-1935
SAMUEL SILVERBERG, et al.,
Appellants in No. 77-1936
FIRST PENNSYLVANIA BANK, N. A.,
Appellant in No. 77-1937

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

D. C. Civil Action No. 72-799

Present: ADAMS, VAN DUSEN and ROSENN, *Circuit Judges.*

Judgment.

This cause on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel on March 28, 1978.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed April 28, 1977, be, and the same is hereby reversed insofar as it granted judgment n.o.v. in favor of the Bank on the securities claim, and the verdict of the jury on the said securities claim be, and the same is hereby reinstated. With respect to the denial of the Silverbergs' motions for judgment n.o.v. and the dismissal of the plaintiff pendent state claim and its refusal to grant judgment on that claim to the plaintiffs or the Bank, the said judgment be, and the same is hereby affirmed.

ATTEST:

THOMAS F. QUINN
Thomas F. Quinn
Clerk

June 14, 1978

APPENDIX B.

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Civil Action No. 72-799

GEORGE R. MONSEN, et al.

v.

CONSOLIDATED DRESSED BEEF COMPANY, INC., et al.

Memorandum and Order.

CAHN, *J.* April 27, 1977

Presently before this court are post trial motions arising out of a jury trial in which the defendants, Consolidated Dressed Beef Company ("Consolidated") and the Silverbergs [1] were found to have violated §§ 12(1) and 12(2) of the Securities Act of 1933 [2] and § 10(b) of the Securities Exchange Act of 1934 [3] and rule 10b-5 [4] promulgated by the Securities Exchange Commission. The jury

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1. The Silverbergs: Samuel, Sidney, Edward, Michael, Reuben, Nathan and Alan, who were the principal officers, directors and shareholders of Consolidated Dressed Beef Company, Inc.

2. 15 U. S. C. § 77*l*.

3. 15 U. S. C. § 78j.

4. 17 C. F. R. § 240.10b-5.

also found that defendant, First Pennsylvania Bank ("Bank"), aided and abetted those violations. The amount of the judgment in favor of the plaintiff against Consolidated is $421,629.30. The remaining defendants were found to be jointly and severally liable in the amount of $152,561.44. The Silverberg defendants move this court for a judgment notwithstanding the verdict. The plaintiff moves this court to reinstate Count III of his complaint, which involves constructive trust violations, or in the alternative for a new trial on that count.

The motions for judgment n.o.v. must be decided by applying the following legal principle.

> [T]he motion for judgment n.o.v. may be granted only when, without weighing the credibility of the evidence, there can be but one reasonable conclusion as to the proper judgment. Where there is conflicting evidence, or there is insufficient evidence to make a 'one-way' verdict proper, judgment n.o.v. should not be awarded. In considering the motion, the court must view the evidence in the light most favorable to the party who secured the jury verdict.

5A MOORE'S FEDERAL PRACTICE ¶ 50.07[2] (2d Ed. 1975). In viewing the evidence in the light most favorable to the party who secured the jury verdict, I must deny the motion for judgment n.o.v. asked for by the Silverbergs. The motion for judgment n.o.v. sought by the Bank is a much closer question and will be discussed in detail below.

The evidence introduced at trial showed a course of conduct on the part of Consolidated and the Silverbergs in which they engaged in the sale of unregistered securities in the form of promissory notes. These notes were sold to employees of Consolidated and friends of the Silverbergs. The evidence also showed that the Bank made loans to

Consolidated on a secured basis. In addition, the Bank had knowledge of the promissory note program and should have known of its illegality. The Bank encouraged the note program to continue which in turn improved the Bank's position as a secured creditor. Under the negative covenants of the loan agreement, the Bank had the authority to require Consolidated to discontinue the note program.

The claim against the Bank is based on allegations of aiding and abetting the other defendants in certain securities violations. In order "[t]o impose liability as an aider-abettor under this section, it is necessary to find three distinct elements: (1) The existence of an independent wrongful act; (2) knowledge by the aider and abettor of that wrongful act; and (3) substantial assistance in effecting that wrongful act." *Rochez Brothers, Inc. v. Rhoads*, 527 F. 2d 880, 886 (3d Cir. 1975); *Landy v. Federal Deposit Insurance Corporation*, 486 F. 2d 139 (3d Cir. 1973); *Saltzman v. Zern*, 407 F. Supp. 49 (E. P. Pa. 1976). The requirements of showing substantial assistance presents the plaintiff with serious problems in this case.[5] In this circuit, in determining whether the assistance is sufficiently substantial to make a party liable for aiding and abetting the wrongful act of another, the courts have looked to the RESTATEMENT OF TORTS § 876 for guidance.[6] According to this section of the RESTATEMENT the relevant considerations are: (1) the amount of assistance given by the defendant; (2) his presence or absence at the time of the tort; (3) his relation to the other person; (4) his state of

5. Although it is not necessary for this court to consider the question of scienter, the absence of proof on that issue raises another problem for the plaintiff. *See* Ernst & Ernst v. Hochfelder, 425 U. S. 185 (1976).

6. Landy v. Federal Deposit Insurance Corporation, 486 F. 2d 139 (3d Cir. 1973); Saltzman v. Zern, 407 F. Supp. 49 (E. D. Pa. 1976).

mind. RESTATEMENT OF TORTS § 876, Comment on Clause (b).

When the evidence is viewed in the light most favorable to the party who secured the verdict, it is clear that the evidence is insufficient for a jury finding of aiding and abetting against the Bank and a judgment n.o.v. should be entered. First, the Bank rendered no assistance to the Silverbergs in regard to the securities violations. Second, the Bank never participated in the offending sales and was absent at the time they occurred. Third, the Bank made no representations to the buyers of the notes nor did it owe those buyers any legal duty of disclosure. Fourth, while it is true that the Bank informally and to a limited extent encouraged the Silverbergs to continue their note program, the evidence failed to establish that the Bank's actions in that regard were intended to further any securities violations. Thus, each of the four considerations tends to absolve the Bank of aiding and abetting liability.

The plaintiff urges, however, that even if the foregoing tests for substantial assistance are not met, the Bank may be liable as an aider and abettor for mere inaction if "the inaction was consciously intended to assist in the perpetration of the wrongful act." *Gould v. American-Hawaiian S.S. Co.*, 535 F. 2d 761, 780 (3d Cir. 1976). *See Rochez Brothers, Inc. v. Rhoads, supra.* This argument of the plaintiff must be rejected.

Courts have generally been reluctant to extend aiding and abetting liability when the secondary defendant's activity is limited to inaction. As a result of this reluctance courts have required a stricter standard of proof in inaction cases.[7] Therefore, I conclude that even if the plaintiff had been able to prove that the Bank consciously intended to assist in a wrongful act, the plaintiff must also show that the consciously intended aid was substantial aid. As was mentioned above, the plaintiff was unable to prove substantial assistance, and therefore, there is a gap in the proof of an element essential to plaintiff's cause of action which necessitates the entry of judgment n.o.v.

7. Rochez Brothers, Inc. v. Rhoads, 527 F. 2d 800 (3d Cir. 1975); Woodward v. Metro Bank of Dallas, 552 F. 2d 84 (5th Cir. 1975); Hochfelder v. Midwest Stock Exchange, 503 F. 2d 364 (7th Cir. 1974).

If this court were to find otherwise, it would place a burden on all banks making loans to police the actions of their customers. Such a result might foreclose avenues of financing for those who need them the most. The federal securities laws do not, as the plaintiff suggests, place a duty on persons who know of possible infractions to take steps to safeguard possible victims.

The court also denies plaintiff's motion to reinstate Count III or in the alternative for a new trial on that count. At the close of the plaintiff's introduction of evidence at trial, this court declined to accept pendent jurisdiction of plaintiff's Count III which was based on a constructive trust theory under Pennsylvania law.[8] It is settled law that the denial or acceptance of pendent jurisdiction is within the sound discretion of the trial judge. In the case of *Robinson v. Penn Central Co.*, 484 F. 2d 553 (3d Cir. 1973), the court stated that the trial court "remains free throughout the proceedings to dismiss such a claim if that seems the fairer course." One of the major criteria to be considered by the court in determining whether to accept or deny pendent jurisdiction is the question of whether the pendent claim will cause jury confusion. *See Saltzman v. Zern, supra.*

In declining to accept pendent jurisdiction over Count III, this court determined that, *inter alia,* further

8. It should be noted diversity of citizenship jurisdiction is lacking.

introduction of evidence on the constructive trust theory, albeit by the defendant, would unduly confuse the jury which had the burden of deciding the federal securities issues. This confusion outweighed the judicial economy and convenience of trying the issues together.

EDWARD N. CAHN,
Edward N. Cahn, *J.*

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Civil Action No. 72-799

GEORGE R. MONSEN, et al.

v.

CONSOLIDATED DRESSED BEEF COMPANY, INC., et al.

Order.

AND Now this 27 day of April, 1977, IT IS ORDERED that:

1. The motion of First Pennsylvania Bank for a judgment notwithstanding the verdict is GRANTED.

2. The motion of the other defendants for a judgment notwithstanding the verdict is DENIED.

3. The motion of the plaintiff to reinstate Count III of its complaint or in the alternative for a new trial on that count is DENIED.

By THE COURT:

EDWARD N. CAHN
Edward N. Cahn, *J.*

APPENDIX C.

Securities Act of 1933.

Civil Liabilities Arising in Connection With Prospectuses & Communications.

SEC. 12. Any person who—

(1) offers or sells a security in violation of section 5, or

(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security. [15 U. S. C. 77(*l*)].

Securities Exchange Act of 1934.

Regulation of the Use of Manipulative and Deceptive Devices.

SECTION 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

. . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. [15 U. S. C. 78(j)].

Rule 10b-5. Employment of Manipulative Deceptive Devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security. [17 C. F. R. 240.10b-5].